The Kinked Demand Curve—What is it all about?

McDonalds has its $1.00 menu- what’s the risk of getting rid of it?

EG-> Equillibrium ->@Price of $1.00, Qd=20,

If McDonald’s raises its price to $1.50, Qd=8🡪 BK stays with its price and Customers will run out the door to BK (note: what’s the Price Elasticity if McD’s raises its’ Price?)

If McDonald’s lower’s its price to 50 cents, Qd jumps to 25, but not higher because BK lowers its price as well. (Price Elasticity?)

Premise of the Kinked Demand Curve-> without collusion, companies are reluctant to change their price because if they raise them, other companies won’t do likewise

If they lower them other companies WILL do likewise

Result-> Demand curve above the ESTABLISHED price is highly elastic (small increase in price leads to LARGE drop in quantity

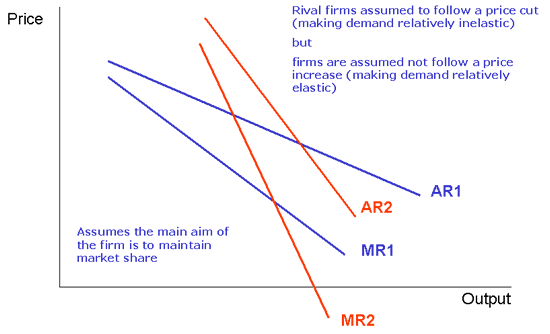
Result->Demand Curve below the ESTABLISHED price is highly Inelastic ( large decrease in prices leads to a SMALL increase in quantity)

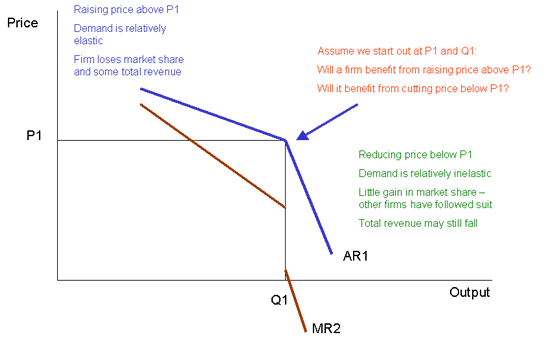
IMPLICATION-> 1. Oligopolist is stuck between the proverbial rock and a hard place

[](http://hschaffer.wordpress.com/2013/02/26/rock-and-a-hard-place/)

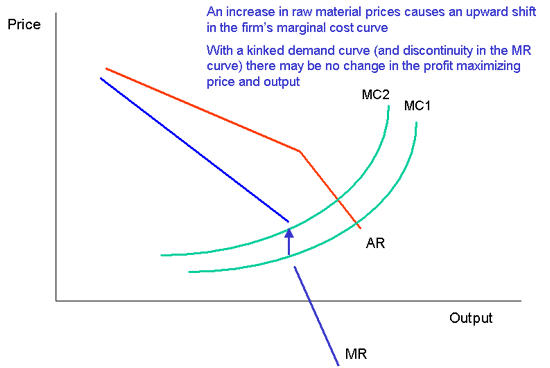
2. There is one demand curve for the area above the ESTABLISHED PRICE that is flat and THERE is a 2ND demand curve for the area below the ESTABLISHED PRICE WHICH IS STEEP [AR in the diagram is the Demand Curve]

3. A unique Marginal Revenue Curve is derived from each Demand Curve



[](http://www.tutor2u.net/economics/content/topics/monopoly/kinked_demand.htm)

4. In the bottom diagram, we see that a rise in marginal costs will not necessarily lead to higher prices providing that the new MC curve (MC2) cuts the MR curve at the same output.



5. This means that companies will be reluctant to alter their prices EVEN WHEN THEIR PRODUCTION COSTS CHANGE—

6. Companies will more likely resort to non-price competition to boost sales, revenue and profits.

PROBLEM

HOW DID WE GET TO THE ESTABLISHED PRICE TO BEGIN WITH?